



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
Internal Revenue Service
10 Causeway Street, Room 581
Boston, MA 02222

July 31, 2007

Number: 201318021
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ORG
ADDRESS

UIL: 501.04-00

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear :

We have enclosed a copy of our report of examination explaining why we believe an adjustment of your organization's exempt status is necessary.

If you do not agree with our position you may appeal your case. The enclosed Publication 3498, *The Examination Process*, explains how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

If you request a conference, we will forward your written statement of protest to the Appeals Office and they will contact you. For your convenience, an envelope is enclosed.

If you and Appeals do not agree on some or all of the issues after your Appeals conference, or if you do not request an Appeals conference, you may file suit in United States Tax Court, the United States Court of Federal Claims, or United States District Court, after satisfying procedural and jurisdictional requirements as described in Publication 3498.

You may also request that we refer this matter for technical advice as explained in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*. If a determination letter is issued to you based on technical advice, no further administrative appeal is available to you within the IRS on the issue that was the subject of the technical advice.

If you accept our findings, please sign and return the enclosed Form 6018, *Consent to Proposed Adverse Action*. We will then send you a final letter modifying or revoking exempt status. If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and this letter will become final. In that event, you will be required to file Federal income tax returns for the tax period(s) shown above. File these returns with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Form 6018
Report of Examination
Envelope

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 20XX12

LEGEND

ORG - Organization name XX - Date Country - country Church - church
CO-1 - 1st COMPANY

Issues

1. Should the tax exempt status of a 501(c)(4) members only organization which operates a bar be revoked?
2. Would the organization qualify under an alternate section of the IRC, such as 501(c)(7) as a social club or 501(c)(8) or 501(c)(10) as a fraternal organization operating under the lodge system?

Explanation of Facts

The organization listed above received exemption in 1941 as a membership organization described in 501(c)(4) of the Code. According to its Articles of Incorporation, the primary purpose of the organization is to "establish and maintain a place for reading rooms and social meetings." Membership is open to men of Country descent, over the age of 21, who are members of a Church. Per a Charter located on the wall of the function hall, prior to receiving its individual exemption under 501(c)(4), the organization was a subordinate to a national organization, the CO-1.

Benefits of membership with ORG include use of the organization's bar and function hall, death/sick benefits and life insurance. Life insurance is offered through the CO-1 (CO-1). ORG directs any fees received from members regarding the life insurance to CO-1, and does not record the transaction in their financial records.

Revenue and expenses of the organization are mainly associated with the operation of the bar., with % of its revenue generated through bar sales, and % from video games located in the bar area. Hall rentals to the public provided only \$ of revenue for 20XX. It is unclear how much income is derived from non-member bar sales, as separate records are not kept. The organization donates \$ (% of its income) to local schools and charitable organizations. All other expenses are associated with general administration and the operation of the bar.

Issue 1:

Should the tax exempt status of a 501(c)(4) members only organization which operates a bar be revoked?

Law

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Section 501(c)(4) of the Code provides, in part, for the exemption from Federal income tax of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)-1(a)(2)(i) of the Regulations states that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterment and social improvements.

Rev. Rul. 66-179, 1966-1 CB 139, states that social activities for the benefit, pleasure, and recreation of members do not preclude exemption under section 501(c)(4) of the Code. However, section 1.501(c)(4)-1(a)(2)(ii) of the regulations provides that an organization will not qualify for exemption as a civic organization described in section 501(c)(4) of the Code if its primary activity is the operation of a social club.

Taxpayer's Position

During the original exit interview, reasons for revocation were discussed with the Chairman (President). The organization was in agreement that they no longer qualify for exemption under 501(c)(4) of the Code. The Form 6018-A is being requested to document their position.

Government's Position

Based on the facts of the examination, the organization does not qualify for exemption under 501(c)(4) of the Code as the operation of a members only bar is not promoting the common good and general welfare of the community. Rev. Rul. 66-179 states that although social activities for members will not preclude exemption, the operation of a social club as the primary activity will. Although a portion of their revenue is donated to community organizations, the primary activity remains the operation of the bar.

Conclusion

Based on the reasons stated above, the organization does not qualify for exemption under 501(c)(4) of the Internal Revenue Code, and its exemption should be revoked.

Issue 2:

Would the organization qualify under an alternate section of the IRC, such as 501(c)(7) as a social club or 501(c)(8) or 501(c)(10) as a fraternal organization operating under the lodge system?

Law

Section 501(c)(7) of the Code provides for the exemption from Federal income tax of clubs organized for pleasure, recreation, and other non-profitable purposes, substantially all of the

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activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

Public Law 94-568, 1976-2 C.B. 596, provides that a social club may receive up to 35 percent of its gross receipts, including investment income from sources outside its membership without losing exemption. Within this 35 percent amount, not more than 15 percent of the gross receipts should be derived from the use of a social club's facilities or services by the general public. This means that an exempt social club may receive up to 35 percent of its gross receipts from a combination of investment income and receipts from nonmembers so long as the latter do not represent more than 15 percent of the total receipts.

Allied Trades Club, Inc. v. Commissioner, 23 T.C. 1017 (1955) states that the payment of sick and death benefits is not a function of a social club exempt under 501(c)(7).

Section 501(c)(8) of the Code provides for the exemption from Federal income tax of fraternal organizations operated under the lodge system who provide payment of sick, death, life or other benefits to their members.

Section 501(c)(8)-1(a) states that a fraternal beneficiary society is exempt from tax only if operated under the lodge system or for the exclusive benefit of the members so operating. Operating under the lodge system means carrying on its activities under a form of organization that comprises local branches, chartered by a parent organization and largely self-governing, called lodges, chapters, or the like. In order to be exempt it is also necessary that the society have an established system for the payment to its members or their dependents of life, sick, accident, or other benefits.

Rev. Rul. 63-190, 1963-2 CB 212, states that a nonprofit organization (not operated under the lodge system), which maintains a social club for members and also provides sick and death benefits for members, does not qualify for exemption as a social club under section 501(c)(7), a civic league under section 501(c)(4), or a fraternal beneficiary society under section 501(c)(8).

Taxpayer's Position

During the original exit interview, the reasons the organization would not qualify under a different subsection were discussed with the Chairman (President). The organization was in agreement that their activities were not within the scope of another subsection.

Government's Position

Based on the facts of the examination, the organization does not qualify under 501(c)(4), 501(c)(7) or 501(c)(8) of the Internal Revenue Code. Basis for revocation under 501(c)(4) is discussed in Issue 1. The organization does not qualify for 501(c)(7) as they offer death benefits to its members. The organization does not keep separate records of its non-member bar sales, so

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its eligibility for 501(c)(7) based on the 35% non-member income limit could not be determined. The organization is not operated under a lodge system, and therefore is not a fraternal organization as described in 501(c)(8) of the Code.

Conclusion

Based on the reasons stated above, the organization does not qualify for exemption under 501(c)(4), 501(c)(7) or 501(c)(8) of the Code.